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NO. 1047

IN THE

Supreme Court of the United States

October Term, 1966

HOMER L. BRUCE, *Petitioner*

v.

UNITED STATES OF AMERICA, *Respondent*

On Petition For A Writ Of Certiorari To The United States Court of Appeals For The Fifth Circuit

REPLY BRIEF OF PETITIONER

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I believe that, if this Court willl consider this my reply to the respondent's memorandum in opposition, it will grant my petition for certiorari. I want primarily to deal with misstatements of fact by respondent and his completely evading the issue under *Burnet v. Logan*, 283 U.S. 404, and his refusal to discuss at all the last sentence of section 613, dealing with percentage depletion, which reads:

> "In no case ~~would~~ shall the allowance for depletion under section 611 be less than it would be if computed without reference to this section."

At the outset I ask where the respondent gets the basis for his flat declaration on page 1,

> "For the years in suit petitioner originally elected to take the percentage depletion deduction of 27½ percent authorized by § 613 of the Internal Revenue Code of 1954."

The years involved are 1960, 1961 and 1962 and I have never claimed the 27½ percent depletion but have asserted my right to recover my entire basis under *Burnet v. Logan,* I quote the following from an exhibit attached to my income tax return for 1960:

> "Trinity Petroleum Trust, Texas National Bank of Houston, Trustee, reported for 1960 taxpayer's taxable income as $ 13,930.85 ordinary income and $738.24 dividend income. However, taxpayer owned 6,152 shares in the trust and received $20,732.24 in cash from the trust. This was community property of his with his wife Clara C. Bruce who passed away on October 14, 1959. For her Federal estate tax these 6,152 shares were valued at $37.00 per share or a total of $227,624.00, which is taxpayer's basis. Owing to the highly speculative character of the trust, taxpayer is entitled to recover this basis out of his receipts. *Burnet v. Logan,* 283 U.S. 404."

Furthermore, as shown by my original complaint (R. 12), the Commissioner assessed the additional taxes involved in the latter part of 1964 and on November 30, 1964, I paid the additional taxes for all three years. I set that out in paragraph 16 of my complaint reading as follows:

> "16. On November 30, 1964, plaintiff paid said $12,714.75, $14,178.90 and $17,761.62 of income taxes and said amounts of interest thereon of $2,744.12, $2,209.38 and $1,701.95 to the District Director of Internal Revenue for the Austin, Texas, District."

How then can respondent make the above statement and state again on page 4 that I originally elected to take the 27½ percent depletion?

Respondent refuses to meet the issue under *Burnet v. Logan,* supra. As shown on pages 11 to 13 of my petition, that case involved two different situations, the first one not being relied upon by me at all and being entirely beside the point but being the only one that respondent discusses. The first situation involved the sale of stock for an interest in payments of 60 cents per ton of iron ore from a mine. That is illustrated by the following at 283 U.S. 412 and 413:

> "The 1916 transaction was a sale of stock—not an exchange of property. We are not dealing with royalties or deductions from gross income because of depletion of mining property. * * * The consideration for the sale was $2,200,000.00 in cash and the promise of future money payments wholly contingent upon facts and circumstances not possible to foretell with anything like fair certainty. The promise was in no proper sense equivalent to cash. It had no ascertainable fair market value. *The transaction was not a closed one.*" (Emphasis added)

I have never at any time relied upon that point in *Burnet v. Logan.* On the other hand, there was another situation involved and that was the money to be received by Mrs. Logan from a similar right in the 60 cents per ton which

she inherited from her mother. That is explicitly set forth at 283 U.S. 413-414:

> "From her mother's estate Mrs. Logan obtained the right to share in possible proceeds of a contract thereafter to pay indefinite sums. The value of this was assumed to be $277,164.50 and its transfer was so taxed. Some valuation—speculative or otherwise—was necessary in order to close the estate. It may never yield as much, it may yield more. If a sum equal to the value thus ascertained had been invested in an annuity contract, payments thereunder would have been free from income tax until the owner had recouped his capital investment. We think a like rule should be applied here."

On page 4 of his memorandum respondent quotes the above statement by the Court that it was not dealing with royalties or deductions. That was in reference to the first transaction which was a sale. The Court certainly was dealing in the second transaction with royalties, that is, an interest in 60 cents per ton or deductions from gross income.

Regardless of respondent's statement in footnote 4 on page 5 that none of the rulings cited by me by the Internal Revenue Service applying *Burnet v. Logan* to oil and gas, I repeat that those rulings did apply to oil and gas that qualified for a depletion deduction. I set out in Appendix E, pages 42 to 48, of my petition a history of the provisions concerning depletion. As early as section 214 of the Revenue Act of 1918 there was the following deduction allowed

> "(10) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance

> for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted: * * *"

Those are the same identical provisions now contained in section 611 of the 1954 Code. (Incidentally when in 1945 I argued the case of *Kirby Petroleum Company v. Commissioner*, 326 U.S. 599, Mr. Justice Black pointed out that the depletion provision required that depletion should be allowed

> "according to the peculiar conditions in each case"

and joined in the decision in that case for the taxpayer.)

Respondent says that I am wrong when I say that by G.C.M. 9798, X-2 C.B. 91 (1933) showed that the Internal Revenue Service applied *Burnet v. Logan* to oil and gas. That ruling involved royalties under an oil and gas lease paid for the years 1923 to 1926. As shown on page 43 of our petition, the Revenue Act of 1926 in section 204(c)(2) first provided for the 27½ percent depletion in addition to the general provision for a reasonable allowance for depletion of oil and gas. That 1926 Act applied to 1926. For 1926 the taxpayer in that case was subject to the provision for reasonable allowance and also to the provision for 27½ percent. Yet the Internal Revenue Service in the ruling stated at page 224 in reference to an oil and gas royalty:

> "In this connection, it is considered unnecessary exhaustively to review the facts. This case is regarded as similar to the Logan case, particularly in the essential fact that in each case there are indeterminate future payments to be made dependent upon

> the yield of mineral products from the property involved. The taxpayers should be allowed to recover the full amount of their capital before treating any portion of the receipts from the contract as income. General Counsel's Memorandum 8650 is modified accordingly."

As heretofore pointed out, the 1926 Revenue Act and all later provisions down through the 1954 Code providing for the 27½ percent depletion stated expressly:

> "In no case ~~would~~ shall the allowance for depletion under section 611 be less than it would be if computed without reference to this section."

Section 611 provides that there shall be a reasonable allowance for depletion. This has been in effect since the Revenue Act of 1918, and yet in *Burnet v. Logan* and other cases and in rulings of the Internal Revenue Service, as above pointed out, where it is uncertain as to how much a taxpayer will recover from oil and gas, he is entitled to recover his basis before being taxed. Respondent says the record shows I will recover my basis. That is true, but the record also is uncontradicted that at 27½ percent depletion I will never recover my basis. Respondent says that I can compute my depletion on a cost basis or take 27½ percent depletion and I have no other choice. In other words, if 27½ percent will not return my basis and it is impossible to compute my cost depletion, as is uncontradicted in this case, I am restricted to 27½ percent. However, section 613 provides that the allowance to me of 27½ percent shall in no case reduce my allowance for depletion if computed without reference to section 613. Frankly, this argument of the Government is wholly unsound and is contrary to the whole history of section 613 and should not be allowed to succeed.

But respondent still says that the fact that the certificates of interest in the Trinity Petroleum Trust are selling for more than my basis precludes me from taking the depletion I claim. This, of course, is directly contrary to the holding of this Court in *Fribourg Navigation Co., Inc. v. Commissioner*, 383 U.S. 272, in which this Court said:

> "The Commissioner argues that depreciation deductions are designed to give a taxpayer deductions equal to the 'actual net cost' of the asset to the taxpayer, and since the sales price of the *Feuer* exceeded the adjusted basis as of the first of the year, the use of the ship during 1957 'cost' the taxpayer 'nothing.' By tying depreciation to sales price in this manner, the Commissioner has commingled two distinct and established concepts of tax accounting—depreciation of an asset through wear and tear or gradual expiration of useful life and fluctuations in the value of that asset through changes in price levels or market values."

In that case this Court held that a rise in sales price had nothing to do with depreciation and the same rule applies to depletion.

While it is recognized that deductions are generally stated to be allowed by Congress as a matter of grace, this is only true where Congress specifically denies the right to a specific deduction. On the other hand without such a denial, the tax laws are generally administered to provide for a tax upon net income, for example, as shown on pages 9 and 10 of our petition, this Court said in *Commissioner v. Tellier*, 383 U.S. 687:

> "We start with the proposition that the federal income tax is a *tax on net income*, not a sanction

against wrongdoing. That principle has been firmly imbedded in the tax statute from the beginning. * * *"

CONCLUSION

I realize that in general this Court grants petitions for certiorari where there is conflict between the instant case and specific decisions by other courts. While I have not cited any specific case in conflict, nevertheless in my opinion the holdings below are definitely in conflict with the decisions cited in this reply brief and in my petition. This case is very simple and, if certiorari should be granted and the case be set down on this Court's summary docket, it could be disposed of very quickly. Then the taxpayers and their counsel would know whether or not the last sentence of section 613 reading:

> "In no case ~~would~~ shall the allowance for depletion under section 611 be less than it would be if computed without reference to this section."

is of any force or effect.

It is respectfully prayed that my petition for writ of certiorari be granted.

Respectfully submitted,

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